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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 04-97-574
Sales and Use Tax
For The Period: 1994 Through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax: Capital Cost Reduction

Authority: IC 6-2.5-1-5; IC 6-2.5-1-6; 45 IAC 2.2-4-27

The taxpayer protests the imposition of sales tax on the capitalized cost reduction of vehicle leases.

II. Sales/Use Tax: Gasoline

Authority: IC 6-2.5-5-8; USAir, Inc. v. Indiana Department of State Revenue, 542 N.E.2d 1033 (Ind. Tax 1989); Indiana Department of State Revenue v. Hertz Corporation, 457 N.E.2d 246 (Ind. App. 2 Dist. 1983).

The taxpayer protests the assessment of tax on gasoline purchased for new cars.

III. Sales/Use Tax: Window Stickers

Authority: IC 6-2.5; Cowden & Sons v. Dept. of State Revenue, 575 N.E.2d 718 (Ind. Tax 1991)

The taxpayer protests the assessment of tax on window stickers for used cars.

STATEMENT OF FACTS

The taxpayer operates an automobile dealership, selling new and used vehicles. The taxpayer's customers include residents of Indiana, Kentucky, and Illinois. The taxpayer also derived income from the sale of parts at retail and wholesale, the service and repair of vehicles, and the finance income from financing and leasing of new and used vehicles through the manufacturers' leasing companies and local banks. More facts will be provided as needed below.

I. Sales/Use Tax: Capital Cost Reduction

DISCUSSION

The taxpayer negotiated lease agreements with its customers. In arriving at the price of a leased vehicle, the final cost to the customer is partially offset by capital cost reductions—"down payments." IC 9-23-2.5-3 defines a capitalized cost reduction as:

> "[C]apitalized cost reduction" means a payment made by cash, check, credit card debit, net vehicle trade-in, rebate, or other similar means in the nature of a down payment or credit, made by a retail lessee at the inception of a lease agreement, for the purpose of reducing the capitalized cost . . . .

The down payments the taxpayer received came in various forms: (1) cash tendered; (2) manufacturer's rebates; (3) and trade-in allowances. The taxpayer collected sales tax on cash down payments and rebates a majority of the time. The taxpayer did not collect sales tax on the net trade-in allowance.

45 IAC 2.2-4-27(d)(1) states that sales/use tax is due on the gross receipts derived from the rental or leasing of tangible personal property. The auditor argues that sales tax must be collected on all lease payments—including capital cost reductions—by the taxpayer. The auditor relies on 45 IAC 2.2-4-27(b)—which states that "the gross receipts from renting or leasing . . . shall constitute a retail transaction subject to the state gross retail tax." Audit reasons that since the trade-in value of the customer's vehicle was consideration given to the taxpayer and was included in the down payment on the lease agreement, then the trade-in allowance was subject to Indiana's gross retail tax (sales tax). The taxpayer argues that the taxation of capitalized cost reduction amounts or trade-ins is improper, and advances the following arguments.

(1) Like kind exchanges

The taxpayer asserts that since trade-in allowances are exempt from sales tax in *purchase transactions*—as like kind exchanges—trade-in allowances should also be exempt in *lease transactions*. As the taxpayer puts it, "IC 6-2.5-1-5(a) does not differentiate between sales-type

and lease-type transactions." Thus, according to the taxpayer, if, *arguendo*, purchase transactions and lease transactions are the same, then the like kind exchange of property is a non-taxable transaction under both headings.

While it is true that the value received in a like kind exchange is not considered to be gross retail income, the taxpayer's lease transactions (i.e., the trade-in of an owned vehicle for a leased vehicle) do not meet the statutory definition of a like kind exchange and therefore do not fall under the rubric of IC 6-2.5-1-5. A like kind exchange is defined in Indiana Code 6-2.5-1-6(a) as:

> "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:
>
> (1) the property exchanged is of the same kind or character, regardless of grade or quality; and
> (2) the persons exchanging the property both own the property prior to the exchange.

The trade-ins involved in these lease transactions were not exchanges of property of the "same kind or character." The customer's vehicle trade-in (tangible personal property) was not exchanged for ownership in another vehicle. Rather, it was exchanged for the *lease* of a vehicle owned by another (which is intangible personal property). Furthermore, the bundle of rights acquired in a lease transaction is not equivalent to that kind acquired in a purchase agreement. Consequently, the property exchanged is not of the same character.

(2) Notification

The taxpayer argues that the Department's 1995 letter to the dealers' trade association, which outlined the taxability of trade-ins in a lease situation, is in conflict with Indiana statutes. As was shown by the analysis above, that is not the case. However, the taxpayer further contends that "even assuming its [the letter] validity, such opinion and the imposition of taxation in reliance upon such opinion should be *prospective* only." The taxpayer argues that the imposition of tax upon trade-ins on a lease transaction should not occur prior to April 26, 1995.

The Department issued the letter in April of 1995, and has taken the position that it will not tax trade-in capital cost reductions that occurred before July 1, 1995—thus giving ample time for the dealers to be aware of Indiana law on this complex issue.

(3) New Statute

Effective July 1, 1997, 6-2.5-5-38.2 was added by our legislature to the Indiana Code. This newly enacted statute explicitly exempts from sales tax the value of vehicles exchanged (traded-

in) in lease transactions. Indiana Code 6-2.5-5-38.2 states:

> The value of an owned vehicle is exempt from the Indiana gross retail tax in a vehicle lease transaction if the owned vehicle is exchanged for a like kind vehicle.

This new law is a departure from previous Indiana law, which, as the Department has shown, allowed the taxation of trade-ins in a lease situation. To conclude otherwise would mean that the legislature merely reiterated Indiana law and added nothing new. Under that interpretation, the law would be redundant and without effect. The Department does not find that reading persuasive or tenable.

The taxpayer also protests the cash down and rebate portions of the capital cost reduction as it relates to out-of-state customers who leased.

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The capital cost reduction (represented by the net trade-in allowance) before July 1, 1995, is not taxed. From July 1, 1995, the capital cost reduction *in toto* is taxable. For the period after July 1, 1997, the capital cost reduction represented by a trade-in of an owned vehicle is not taxable, any other form of capital cost reduction after July 1, 1997, is taxable. With regard to the out-of-state customers who leased, the taxpayer is denied. The taxpayer collected the initial amounts (whether in the form of cash down or rebate) and thus is required to remit the tax. The audit division is requested to review the taxpayer's records to ascertain whether the taxpayer was in comportment with the above finding.

II. Sales/Use Tax: Gasoline

DISCUSSION

Gasoline is provided to new vehicle buyers at no additional charge. New vehicles arrive at the taxpayer's dealership with only one gallon of gasoline. Manufacturers require that the customer receive a full-tank of gas with the purchase or lease of a new vehicle. The manufacturers then give the taxpayer an allowance to help compensate for the cost of gasoline. The allowance is not based on gallons or price per gallon to the dealer.

The taxpayer avers that the gasoline is not taxable, and contends that it is "incorporated in and resold to consumers." Further, the taxpayer contends that there is no statutory requirement of separate bargaining or statement of the specific fuel cost when incorporated in the vehicle. The auditor, in contrast, cites USAir, Inc. v. Indiana Department of Revenue, 542 N.E.2d 1033 (Ind. Tax 1989), which held that "complimentary" meals provided on an airline were not a "resale" and thus not exempt. As the court stated, "It would strain the definition of "resale" to conclude that USAir is reselling the food to its crew and passengers when there is nothing in the price of

the ticket to reflect the price of the meals and snacks." Id. at 1036.

Indiana Department of State Revenue v. Hertz Corp., 457 N.E.2d 246, also supports the Department's position. In that case, bulk fuel purchases by an automobile lessor were held to be for resale to lessees and thus qualified for exemption from sales/use tax. That holding, on its face, seems to cut against the Department's position. But the facts that the Court of Appeals found salient in reaching their holding support the Department's position for the case at hand. Those pertinent facts were that Hertz offered two types of leases: (1) dry leases and (2) wet leases. Under the dry lease, the customer has the obligation of acquiring gasoline during the life of the lease. Hertz imposed a "refueling" charge based on the amount of fuel required to fill the tank if the customer did not return the vehicle fully fueled. That charge was "separately stated on the rental agreement and is paid by the customer at the time of, and in addition to, the payment of the lease charge for the vehicle." Id. at 249. Under the second rubric, the so-called "wet lease," the lease rate is greater than the cost of the dry lease, and the difference between the two is the gasoline provided by Hertz during the course of the lease. The court noted that there is consideration paid for the gasoline at the inception of the wet lease—an increased charge per mile which represented the "cost to the customer during which the vehicle is propelled by that initial tank of gasoline." Id. at 250.

The facts at hand are similar to USAir and dissimilar to Hertz. In the former case, the Tax Court noted that separate bargaining and consideration are salient features in determining whether a resale had occurred. USAir did not show specific cost or separate bargaining of the items at issue. Neither does the taxpayer in the case at hand. The taxpayer's situation is unlike Hertz, since Hertz *did* show the fuel costs and consideration required for it, and had multiple fuel options to reflect this.

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The taxpayer's protest is denied.

III. Sales/Use Tax: Window Stickers

DISCUSSION

The taxpayer protests the imposition of tax on window stickers placed on used vehicles. The taxpayer states that federal law mandates that used vehicles have a window sticker with warranty information on it. The taxpayer has an outside company print and put the stickers on the used vehicles. The taxpayer argues that the majority of the cost of the window sticker is in information gathering, and that the stickers are in the nature of a service.

The taxpayer receives tangible personal property—*viz.*, the window stickers. The outside company does not simply provide printing and information gathering. The outside company also

provides the stickers on which the work is done. The taxpayer contends that the actual property involved is less than 10% of the cost for the "service." However, taxpayer merely asserts this last proposition. Given that it is unsubstantiated, the Department need not address it.

It is worth noting though, that the taxpayer's situation may fall under Indiana Code 6-2.5-1-1(a)—unitary transaction. The substance of the taxpayer's transaction with the outside company was for tangible personal property. Hence under the "unitary transaction" provisions of the Indiana Code, the taxpayer would still be liable for tax on the window stickers. The holding of the Tax Court in Cowden & Sons v. Dept. of State Revenue, 575 N.E.2d 718 (Ind. Tax 1991) would also apply. In Cowden the tax court announced the "inextricable and indivisible" test for unitary transactions. Id. at 722. The court stated that "the divisibility of a transaction is indicated by the temporal relationship between the provision of the services and the transfer of the property . . . services performed prior to a transfer of property indicate an inextricable transaction wholly subject to tax . . . ." Id. Under this temporal test, the services (*e.g.*, information gathering) occur prior to the transfer of the property. Thus the services are indivisible and inextricable, making the entire transaction subject to tax.

FINDING

The taxpayer's protest is denied.